A Report
to the
Montana
Legislature

Financial-Compliance Audit

Montana State Fund

For the Two Fiscal Years Ended June 30, 2010

November 2010

Legislative Audit
Division

10-05A

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Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

November 2010

The Legislative Audit Committee
of the Montana State Legislature:

This report, along with our financial audit report (08-05B), constitutes our financial-compliance audit report of the Montana State Fund, a component unit of the state of Montana, for the two fiscal years ended June 30, 2010. We made no recommendations to the Montana State Fund in the prior audit report. This report contains no recommendations. On page A-1, you will find the independent auditor's report. We issued an unqualified opinion on the financial statements, which means the reader can rely on the information presented.

Montana State Fund's response to our audit is on page B-1. We thank the Montana State Fund staff for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

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Appointed and Administrative Officials

Montana State Fund	Laurence Hubbard, President/CEO	
	Mark Barry, Vice President, Corporate Support	
	Richard Duane, Vice President, Human Resources	
	Richard Root, Vice President, Insurance Operations	
	Peter Strauss, Vice President, Insurance Operations Support	
	Nancy Butler, General Counsel	
	Al Parisian, Chief Information Officer	
State Fund Board of Directors		Term Expires
	Joe Dwyer, Chairman	2011
	Jane Debruycker	2013
	Thomas R. Heisler	2013
	Ken Johnson	2013
	James Swanson	2013
	Boyd Taylor	2011
	Wally Yovetich	2011

For additional information concerning the Montana State Fund contact:

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Montana Legislative Audit Division

Financial-Compliance Audit

Montana State Fund

For the Two Fiscal Years Ended June 30, 2010

November 2010 | 10-05A | Report Summary

The Montana State Fund (MSF) is a nonprofit, independent public corporation established under Title 39, chapter 71 of the Montana Code Annotated. MSF provides Montana employers with an option for workers' compensation and occupational disease insurance and guarantees available coverage for all employers in Montana. MSF is administratively attached to the state of Montana, Department of Administration.

Context

MSF is governed by a seven-member board of directors appointed by the Governor. The Board has full power, authority, and jurisdiction in the administration of MSF as fully and completely as the governing body of a private mutual insurance carrier.

MSF separately presents claims incurred on or after July 1, 1990 (New Fund) and claims incurred prior to July 1, 1990 (Old Fund). In fiscal year 2010, new fund premiums were $166 million and claims were $153 million. At fiscal year end, approximately 25,253 active policies were insured by MSF. Old fund claims were $1.8 million in fiscal year 2010. Adequate funding of the Old Fund is statutorily the responsibility of the state of Montana's General Fund. Based on the current actuarially estimated payout patterns for the Old Fund, the cash and invested assets are expected to be inadequate to cover the total obligations through fiscal year 2011.

Results

There are no recommendations to MSF in the current audit report.

Recommendation Concurrence	
Concur	0
Partially Concur	0
Do Not Concur	0
Source: Agency audit response included in final report.	

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Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Montana State Fund (MSF) for the two fiscal years ending June 30, 2010.

The objectives of this audit were to:

1. Determine whether MSF complied with selected state laws.
2. Obtain an understanding of the MSF's control systems to the extent necessary to support our audit of MSF's financial statements, and if appropriate, make recommendations for improvement in management and internal controls of MSF.
3. Determine whether the MSF's and the State of Montana-Old Fund's financial statements present fairly the financial position and results of operations for the fiscal year ended June 30, 2010, with comparative financial amounts for the fiscal year ended June 30, 2009.

Our financial audit of the MSF's and State of Montana - Old Fund's financial statements for the two fiscal years ended June 30, 2009, was issued in a separate report (08-05B).

MSF personnel prepared the financial statements from the Statewide Accounting, Budgeting, and Human Resources System with adjustment. Adjustments are made to accurately present financial activity.

This report contains no recommendations. Issues deemed not to have significant effect on operations have been discussed with management but are not included in this report.

Background

Montana State Fund is a nonprofit, independent public corporation that provides Montana employers with an option for workers' compensation and occupational disease insurance, and acts as the insurer of last resort. Montana State Fund is governed by a seven-member board of directors appointed by the governor. State law separates funding sources for claims incurred before July 1, 1990, (Old Fund) and those incurred on or after July 1, 1990 (New Fund).

Montana State Fund management must set premium rates for the New Fund at amounts sufficient, when invested, to carry the estimated cost of all claims to maturity, to meet the reasonable expenses of conducting the business of the New Fund, and to

maintain a surplus over the amount produced by the National Association of Insurance Commissioners' risk-based capital requirements for a casualty insurer. The Old Fund costs are currently funded by investment earnings and investment principal. If Old Fund assets are insufficient, then, by law, the state General Fund will provide funding for claims. The investments of the Montana State Fund New Fund and the Old Fund are managed by the Montana Board of Investments and invested according to policies established in law.

Prior Audit Recommendations

We performed the prior audit of the Montana State Fund for the two fiscal years ended June 30, 2009. The report contained no recommendations. The prior financial-compliance audit report (08-05A) included one disclosure issue related to the accounting for MSF's new office building. In April 2010, the Montana State Fund board of director's met and agreed to work with the Board of Investments to transfer title of the land, building, and ownership of all warranties for equipment and features in the building to the Montana State Fund. In addition, MSF will assume the obligation of the Board of Investments for the annual purchase of 350 parking permits for use by MSF employees in the City of Helena parking garage.

Independent Auditor's Report and Montana State Fund and State of Montana–Old Fund Financial Statements

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Statements of Net Assets of the Montana State Fund and the State of Montana – Old Fund, a component unit of the state of Montana, as of June 30, 2010, and 2009, and the related Statements of Revenues, Expenses, and Changes in Fund Net Assets, Montana State Fund and State of Montana – Old Fund, and Statements of Cash Flows, Montana State Fund and State of Montana – Old Fund, for each of the fiscal years then ended. The information contained in these financial statements is the responsibility of the Montana State Fund's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana State Fund and State of Montana – Old Fund as of June 30, 2010, and 2009, and the respective results of operations and cash flows for each of the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying Management's Discussion and Analysis and Schedule of Funding Progress for MSF are not required parts of the financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

October 15, 2010

Montana State Fund and The State of Montana-Old Fund
Management's Discussion and Analysis,
Financial Statements, Notes, and
Required Supplemental Information

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Management Discussion and Analysis
June 30, 2010 and 2009

Overview of the Financial Statements

This overview is an introduction to Montana State Fund (MSF) and the Old Fund financial statements. The financial statements consist of two components: (1) basic financial statements, and (2) notes to the basic financial statements.

The statement of net assets presents information regarding all of MSF's and Old Fund's assets and liabilities, with the difference between the two being reported as net assets.

The statements of revenue, expenses, and changes in fund net assets present the financial results of operations for MSF and the Old Fund for the two most recent fiscal years. This statement presents information showing how the net assets changed during the two most recent fiscal years. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods.

The statement of cash flows details the cash used and provided by the various activities of MSF and the Old Fund during the fiscal year. However, this statement does not consider unpaid responsibilities which have been established by contract or other underlying events during the fiscal year.

MSF restated fiscal year 2009 to establish the correct recording of written premium in the statement of operations. The receivable for unbilled premium receivable and the liability for unearned premium were recorded as restated amounts for fiscal year 2009 with an adjustment to equity in the amount of $3.4M.

The following analysis presents two years of comparative condensed financial data for MSF and the Old Fund.

Analysis of Financial Position - MSF

The following is a comparison of the financial position of MSF at June 30, 2010 to 2009 (Restated), (In thousands):

	6/30/2010	6/30/2009 (Restated)	Change
Assets:			
Cash and STIP	$ 28,149	$ 31,389	$ (3,240)
Investments	1,102,416	993,222	109,194
Security Lending Collateral	167,515	175,758	(8,243)
Receivables (Net)	63,970	69,129	(5,159)
Capital Assets (Net)	37,719	19,890	17,829
Other Assets	62,626	50,287	12,339
Total Assets	$ 1,462,395	$ 1,339,675	$ 122,720
Liabilities:			
Loss and LAE Reserves	$ 838,765	$ 813,305	$ 25,460
Liability for Securities on Loan	167,515	175,758	(8,243)
Payables	19,590	17,825	1,765
Other Liabilities	119,649	111,796	7,853
Total Liabilities	1,145,519	1,118,684	26,835
Net Assets:			
Investment in Capital Assets	37,719	19,890	17,829
Unrestricted Net Assets	279,157	201,101	78,056
Total Net Assets	316,876	220,991	95,885
Total Liabilities and Net Assets	$ 1,462,395	$ 1,339,675	$ 122,720

Net Assets increased approximately $95.9M (million) in fiscal year 2010 compared to fiscal year 2009, primarily due to unrealized gains on investments. Loss and LAE Reserves increased by $25.5M. Cash and Short-term investment pool (STIP) and Investments increased by $106.0M in comparison to a $48.7M increase in the previous fiscal year. Other assets increased $16.8M and other liabilities increased $1.4M.

The increase in Capital Assets is the result of the completion of construction of the MSF office building that it now occupies. For the fiscal year ended June 30, 2010, MSF financial statements include $1.14M in land and $27.8M in buildings. (Note 1- Other Assets in the Notes to the Financial Statements provides additional information.)

The change in market value of MSF's investment portfolio of fixed and equity securities in fiscal year 2010 was as follows, (In thousands):

Fiscal Year 2009 Market Value	$ 993,222
Purchases at Cost	219,627
Sales	(186,920)
Net Realized Gains	2,183
Net Accretion of Bonds	345
Unrealized Gain (Loss)	73,958
Fiscal Year 2010 Market Value	$ 1,102,416

Towers Watson, an independent actuarial firm, prepares an actuarial study used to estimate liabilities, including claim adjustment expenses and the ultimate cost of settling claims reported but not settled and claims incurred but not reported (IBNR) for MSF as of June 30, 2010 and June 30, 2009. Towers Watson provides a range of potential costs associated with reported claims, the future development of those claims and IBNR. MSF management has selected a central estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2010 and 2009. The estimated claims payable is presented undiscounted, net of estimated reinsurance recoverable, at $838.8M and $813.3M, as of June 30, 2010, and June 30, 2009, respectively.

The following is a comparison of the financial position of MSF at June 30, 2009 (Restated), to June 30, 2008, (In thousands):

	6/30/2009 (Restated)	6/30/2008	Change
Assets:			
Cash and STIP	$ 31,389	$ 23,286	$ 8,103
Investments	993,222	952,604	40,618
Security Lending Collateral	175,758	143,711	32,047
Receivables (Net)	69,129	30,044	39,085
Capital Assets (Net)	19,890	10,049	9,841
Other Assets	50,287	38,168	12,119
Total Assets	$ 1,339,675	$ 1,197,862	$ 141,813
Liabilities:			
Loss and LAE Reserves	$ 813,305	$ 752,253	$ 61,052
Liability for Securities on Loan	175,758	143,711	32,047
Payables	17,825	19,368	(1,543)
Other Liabilities	111,796	57,978	53,818
Total Liabilities	1,118,684	973,310	145,374
Net Assets:			
Investment in Capital Assets	19,890	10,049	9,841
Unrestricted Net Assets	201,101	214,503	(13,402)
Total Net Assets	220,991	224,552	(3,561)
Total Liabilities and Net Assets	$ 1,339,675	$ 1,197,862	$ 141,813

Net Assets decreased approximately $3.6M in fiscal year 2009 compared to fiscal year 2008. Loss and LAE Reserves increased by $61.0M. Total Assets increased $141.8M which includes an increase in Cash and Short-term investment pool (STIP) and Investments by $48.7M, an increase in Security Lending Collateral of $32.0M and the recording of the unbilled premium receivable of $48.9M. Total Liabilities increased by $145.4M which includes an increase in Loss and LAE Reserves of $61.1M, an increase in Liability for Securities on Loan of $32.0M and the recording of the unearned premium liability of $51.6M.

The change in market value of MSF's investment portfolio of fixed and equity securities in fiscal year 2009 was as follows, (In thousands):

Fiscal Year 2008 Market Value	$ 952,604
Purchases at Cost	243,834
Sales	(174,984)
Net Realized Losses	(13,625)
Net Accretion of Bonds	498
Unrealized Gain (Loss)	(15,104)
Fiscal Year 2009 Market Value	$ 993,222

MSF management selected a central estimate within the range established by Towers Watson as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2009 and 2008. The estimated claims payable was presented undiscounted, net of estimated reinsurance recoverable, at $813.3M and $752.3M, as of June 30, 2009, and June 30, 2008, respectively.

Results of Operations – MSF

The following is a comparison of MSF's results of operations for fiscal year 2010 to fiscal year 2009 (Restated), (In thousands):

	6/30/2010	6/30/2009 (Restated)	Change
Operating Revenues:			
Net Premium Earned	$ 166,265	$ 203,976	$ (37,711)
Total Operating Revenue	166,265	203,976	(37,711)
Operating Expenses:			
Benefits and Claims	153,095	185,514	(32,419)
Personal Services	22,716	22,138	578
Other Operating Expense	13,589	18,576	(4,987)
Total Operating Expense	189,400	226,228	(36,828)
Net Operating Income (Loss)	(23,135)	(22,252)	(883)
Nonoperating Revenue (Expense):			
Investment Income	120,519	17,306	103,213
Other Nonoperating Revenue	503	2,013	(1,510)
Dividend Expense	(2,001)	(3,997)	1,996
Total Nonoperating Revenue (Expense)	119,021	15,322	103,699
Prior Year Correction (Restated)	0	3,369	(3,369)
Change in Net Assets	$ 95,886	$ (3,561)	$ 99,447

MSF's book of business decreased 18.5% from $204.0M of net earned premium in fiscal year 2009 to $166.0M of net earned premium in fiscal year 2010. The economic conditions caused a decline in the amount of payroll reported by policyholders. Montana's unemployment rate increased from 6.7% in June 2009 to 7.4% in June 2010.

MSF paid dividends to policyholders of $2.0M in fiscal year 2010 and $4.0M in fiscal year 2009. The Board of Directors, at its discretion, determines the amount of dividends to be declared.

Investment income increased by $103.2M in fiscal year 2010 over investment income in fiscal year 2009. This increase was primarily due to unrealized gain on investments as MSF experienced an unrealized gain of $74.0M in fiscal year 2010, compared to an unrealized loss on investments of ($15.1M) in fiscal year 2009. Total net realized gains on investments for fiscal year 2010 were $2.2M compared to ($13.6M) net realized losses reported in fiscal year 2009.

The following is a comparison of MSF's results of operations for fiscal year 2009 (restated) to fiscal year 2008, (In thousands):

	6/30/2009 (Restated)	6/30/2008	Change
Operating Revenues:			
Net Premium Earned	$ 203,976	$ 230,965	$ (26,989)
Total Operating Revenue	203,976	230,965	(26,989)
Operating Expenses:			
Benefits and Claims	185,514	201,333	(15,819)
Personal Services	22,138	22,984	(846)
Other Operating Expense	18,576	17,672	904
Total Operating Expense	226,228	241,989	(15,761)
Net Operating Income (Loss)	(22,252)	(11,024)	(11,228)
Nonoperating Revenue (Expense):			
Investment Income	17,306	32,861	(15,555)
Other Nonoperating Revenue	2,013	1,109	904
Dividend Expense	(3,997)	0	(3,997)
Total Nonoperating Revenue (Expense)	15,322	33,970	(18,648)
Prior Year Correction (Restated)	3,369	0	3,369
Change in Net Assets	$ (3,561)	$ 22,946	$ (26,507)

MSF's book of business decreased 11.7% from $231.0M of net earned premium in fiscal year 2008 to $204.0M of net earned premium in fiscal year 2009. The economic conditions caused a decline in the amount of payroll reported by policyholders, and a 3% rate decrease reduced the net premium for 2009. Montana's unemployment rate increased from 4.4% in June 2008 to 6.7% in June 2009.

MSF paid dividends of $4.0M to policyholders in the first half of fiscal year 2009. MSF did not pay a dividend in fiscal year 2008 due to a change in the annual schedule of when the dividends are considered and declared by the board.

Investment income decreased by ($15.6M) in fiscal year 2009 over investment income earned in fiscal year 2008. This decrease was primarily due to realized losses on bonds due to write-downs and sales. Total net realized losses on investments for fiscal year 2009 were ($13.6M) compared to ($114K) in fiscal year 2008.

MSF experienced an unrealized loss on investments of ($15.1M) in fiscal year 2009, compared to an unrealized loss on investments of ($10.4M) in fiscal year 2008. This was primarily due to

the decrease in fair value of equities of ($21.7M) in fiscal year 2009, offset by unrealized gains on investments in bonds of $6.6M.

Analysis of Financial Position – Old Fund

The following is a comparison of the financial position of the Old Fund at June 30, 2010, to June 30, 2009, (In thousands):

	6/30/2010	6/30/2009	Change
Assets:			
Cash and STIP	$ 6,107	$ 13,268	$ (7,161)
Investments	4,167	7,374	(3,207)
Security Lending Collateral	1,336	1,569	(233)
Receivables (Net)	72	161	(89)
Total Assets	$ 11,682	$ 22,372	$ (10,690)
Liabilities:			
Loss and LAE Reserves	$ 57,994	$ 65,575	$ (7,581)
Liability for Securities on Loan	1,336	1,569	(233)
Payables	519	723	(204)
Total Liabilities	59,849	67,867	(8,018)
Net Assets:			
Unrestricted Net Assets	(48,167)	(45,495)	(2,672)
Total Net Assets	(48,167)	(45,495)	(2,672)
Total Liabilities and Net Assets	$ 11,682	$ 22,372	$ (10,690)

Net Assets decreased ($2.7M) from the prior fiscal year. The primary reason for this decrease is the continuing development on remaining loss reserves increasing the estimated amount remaining to be paid on outstanding claims. The decreases in net assets have left a deficit of ($48.2M).

The change in market value of Old Fund's investment portfolio of fixed securities in fiscal year 2010 was as follows, (In thousands):

Fiscal Year 2009 Market Value	$ 7,374
Purchases at Cost	353
Sales	(3,483)
Net Realized Gains	5
Net Amortization of Bonds	(5)
Par Value Adjustment	-
Unrealized Gain (Loss)	(77)
Fiscal Year 2010 Market Value	$ 4,167

Towers Watson, an independent actuarial firm, prepares an actuarial study used to estimate liabilities, including claim adjustment expenses and the ultimate cost of settling claims reported but not settled and claims incurred but not reported (IBNR) for the Old Fund as of June 30, 2010, and June 30, 2009. Towers Watson provides a range of potential costs associated with reported claims, the future development of those claims and IBNR. MSF management has selected the Towers Watson estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2010 and 2009. The estimated claims payable is presented discounted at $58.0M and $65.6M, as of June 30, 2010 and June 30, 2009, respectively. The discount rate used to calculate present value is based on an estimate of expected investment yield and considers the risk of adverse deviation in the future from such yield. The Old Fund discounted its actuarially determined unpaid balances by a factor of 3.5% for the period ended June 30, 2010 and June 30, 2009. The estimated claims payable undiscounted for fiscal years 2010 and 2009, respectively, is $71.1M and $79.2M.

The following is a comparison of the financial position of the Old Fund at June 30, 2009 to June 30, 2008, (In thousands):

	6/30/2009	6/30/2008	Change
Assets:			
Cash and STIP	$ 13,268	$ 12,383	$ 885
Investments	7,374	19,925	(12,551)
Security Lending Collateral	1,569	4,179	(2,610)
Receivables (Net)	161	382	(221)
Total Assets	$ 22,372	$ 36,869	$ (14,497)
Liabilities:			
Loss and LAE Reserves	$ 65,575	$ 68,435	$ (2,860)
Liability for Securities on Loan	1,569	4,179	(2,610)
Payables	723	767	(44)
Total Liabilities	67,867	73,381	(5,514)
Net Assets:			
Unrestricted Net Assets	(45,495)	(36,512)	(8,983)
Total Net Assets	(45,495)	(36,512)	(8,983)
Total Liabilities and Net Assets	$ 22,372	$ 36,869	$ (14,497)

Net Assets decreased ($9.0M) from the prior year. The primary reason for this decrease is the continuing development on remaining loss reserves increasing the estimated amount remaining to be paid on outstanding claims. The decreases in net assets have left a deficit in the net asset account of ($45.5M).

The change in market value of Old Fund's investment portfolio of fixed securities in fiscal year 2009 was as follows, (In thousands):

Fiscal Year 2008 Market Value	$ 19,925
Purchases at Cost	1,133
Sales	(13,476)
Net Realized Losses	(266)
Net Amortization of Bonds	(17)
Par Value Adjustment	(1)
Unrealized Gain (Loss)	75
Fiscal Year 2009 Market Value	$ 7,374

MSF management selected the Towers Watson central estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2009 and 2008. The estimated claims payable is presented discounted at $65.6M and

$68.4M, as of June 30, 2009 and June 30, 2008, respectively. The discount rate used to calculate present value is based on an estimate of expected investment yield and considers the risk of adverse deviation in the future from such yield. The Old Fund discounted its actuarially determined unpaid balances by a factor of 3.5% for the period ended June 30, 2009, and 4.5% for the period June 30, 2008. The estimated claims payable undiscounted for fiscal years 2009 and 2008, respectively, is $79.2M and $86.7M.

Results of Operations – Old Fund

The following is a comparison of Old Fund's results of operations for fiscal year 2010 to fiscal year 2009, (In thousands):

	6/30/2010	6/30/2009	Change
Operating Expenses:			
Benefits and Claims	$ 1,783	$ 8,265	$ (6,482)
Personal Services	2	7	(5)
Other Operating Expense	1,113	1,282	(169)
Total Operating Expense	2,898	9,554	(6,656)
Nonoperating Revenue:			
Investment Income	225	571	(346)
Total Nonoperating Revenue	225	571	(346)
Change in Net Assets	$ (2,673)	$ (8,983)	$ 6,310

Benefits and Claims expense for fiscal year 2010 includes adverse development of $2.4M while the same expense for fiscal year 2009 includes $4.3M in adverse development.

State law (Section 39-71-2352, MCA) requires MSF to separately determine and account for administrative expenses and benefit payments for claims for injuries resulting from accidents occurring before July 1, 1990 (Old Fund) from those occurring on or after July 1, 1990 (MSF). The law also limits annual administrative costs of claims associated with the Old Fund to $1.25M for both fiscal years 2010 and 2009. MSF allocated $955K in administration costs to the Old Fund in fiscal year 2010 and $1.25M in fiscal year 2009. The Old Fund no longer has an obligation to MSF in un-recovered administrative costs incurred in fiscal years 2010 and prior.

The following is a comparison of Old Fund's results of operations for fiscal year 2009 to fiscal year 2008, (In thousands):

	6/30/2009	6/30/2008	Change
Operating Expenses:			
Benefits and Claims	$ 8,265	$ 4,659	$ 3,606
Personal Services	7	11	(4)
Other Operating Expense	1,282	1,401	(119)
Total Operating Expense	9,554	6,071	3,483
Nonoperating Revenue:			
Investment Income	571	2,193	(1,622)
Total Nonoperating Revenue	571	2,193	(1,622)
Change in Net Assets	$ (8,983)	$ (3,878)	$ (5,105)

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Montana State Fund
Statement of Net Assets
Montana State Fund is a component unit of the State of Montana

June 30,		2010		2009 (Restated)
ASSETS				
Current Assets				
Cash and Cash Equivalents	$	28,148,675	$	31,389,015
Receivables, Net		63,970,492		68,575,407
Due from Primary Government		-		5,033
Due from Old Fund		-		548,648
Securities Lending Collateral		167,514,931		175,758,454
Other Assets		5,561,661		7,051,964
Total Current Assets		265,195,759		283,328,521
Noncurrent Assets				
Investments		1,102,415,833		993,222,091
Reinsurance Receivables		57,063,883		43,234,690
Equipment, Net		4,262,927		942,077
Land		1,139,460		1,139,460
Buildings, Net		27,793,885		-
Construction Work in Progress		-		11,790,414
Intangible Assets		4,523,222		6,017,661
Total Noncurrent Assets		1,197,199,210		1,056,346,393
Total Assets	$	1,462,394,969	$	1,339,674,914
LIABILITIES				
Current Liabilities				
Accounts Payable	$	19,573,080	$	16,477,927
Due to Primary Government		16,981		1,320,579
Due to Old Fund		-		26,634
Estimated Claims Payable		113,547,592		137,985,395
Compensated Absences		928,022		1,129,304
Securities Lending Liability		167,514,931		175,758,454
Unearned Premium		47,054,326		51,551,679
Policyholder Deposits		3,245,060		3,875,135
Total Current Liabilities		351,879,992		388,125,107
Noncurrent Liabilities				
Estimated Claims Payable		725,217,748		675,319,317
Reinsurance Funds Withheld		64,235,976		52,097,910
Compensated Absences		1,622,553		1,389,308
Other Post Employment Benefits		2,561,741		1,752,904
Total Noncurrent Liabilities		793,638,018		730,559,439
Total Liabilities		1,145,518,010		1,118,684,546
NET ASSETS				
Invested in Capital Assets, Net of Related Debt		37,719,494		19,889,612
Unrestricted		279,157,465		201,100,756
Total Net Assets		316,876,959		220,990,368
Total Liabilities and Net Assets	$	1,462,394,969	$	1,339,674,914

The notes to the financial statements are an integral part of this statement.

Montana State Fund
Statement of Revenues, Expenses, and Changes in Fund Net Assets
Montana State Fund is a component unit of the State of Montana

YEAR ENDED JUNE 30,	2010	2009 (Restated)
Net Premiums Earned	$ 166,265,384	$ 203,976,354
Operating Expenses		
Benefits and Claims	153,094,853	185,513,924
Personal Services	22,716,285	22,138,406
Contractual Services	1,087,974	5,282,787
Supplies and Materials	1,083,989	462,802
Depreciation	410,496	517,800
Amortization	2,093,322	1,461,828
Rent and Utilities	440,495	466,325
Communications	1,551,777	1,337,269
Travel	195,219	219,620
Repair and Maintenance	1,352,644	1,263,454
Other Operating Expenses	5,372,709	7,563,463
Total Operating Expenses	189,399,763	226,227,677
Operating Income (Loss)	(23,134,379)	(22,251,324)
Nonoperating Revenue(Expenses)		
Investment Income	120,518,771	17,305,580
Securities Lending Income	950,244	3,420,076
Securities Lending Expenses	(394,677)	(1,491,080)
Penalties and Interest	42,968	71,848
Loss on Retirement of Assets	(114,667)	(6,350)
Dividend Expense	(2,001,293)	(3,996,599)
Other Income	19,624	18,104
Total Nonoperating Revenue(Expenses)	119,020,970	15,321,578
Change in Net Assets	95,886,591	(6,929,746)
Total Net Assets - Beginning (As Restated)	220,990,368	227,920,114
Total Net Assets - Ending	$ 316,876,959	$ 220,990,368

The notes to the financial statements are an integral part of this statement.

Montana State Fund
Statement of Cash Flows
Montana State Fund is a component unit of the State of Montana

YEAR ENDED JUNE 30,	2010	2009
Cash Flows from Operating Activities		
Receipts for Premiums	170,059,904	204,050,563
Payments to Suppliers for Goods and Services	(6,876,130)	(18,455,256)
Payments to Employees	(22,500,111)	(22,206,875)
Cash Payments for Claims	(126,954,464)	(124,716,354)
Other Operating Receipts	62,592	89,952
Net Cash Provided by (Used for) Operating Activities	13,791,791	38,762,029
Cash Flows from Noncapital Financial Activities		
Payment of Dividends to Policyholders	(2,001,293)	(3,996,599)
Net Cash Provided by (Used for) Noncapital Financing Activities	(2,001,293)	(3,996,599)
Cash Flows from Capital and Related Financing Activities		
Acquisition of Fixed Assets	(20,290,188)	(12,267,023)
Proceeds from Sale of Fixed Assets	(114,667)	(6,350)
Net Cash Used for Capital and Related Financing Activities	(20,404,855)	(12,273,373)
Cash Flows from Investing Activities		
Purchase of Investments	(226,680,416)	(265,377,998)
Proceeds from Sales or Maturities of Investments	186,920,005	203,321,905
Proceeds from Securities Lending Transactions	950,245	3,379,067
Payments of Security Lending Costs	(363,337)	(1,450,072)
Interest and Dividends on Investments	44,547,520	45,738,257
Net Cash Provided by (Used For) Investing Activities	5,374,017	(14,388,841)
Net Increase (Decrease) in Cash and Cash Equivalents	(3,240,340)	8,103,216
Cash and Cash Equivalents - July 1	31,389,015	23,285,799
Cash and Cash Equivalents - June 30	28,148,675	31,389,015

The notes to the financial statements are an integral part of this statement.

Montana State Fund
Statement of Cash Flows
Montana State Fund is a component unit of the State of Montana

YEAR ENDED JUNE 30,	2010	2009
Reconciliation of Change in Net Assets to Net Cash Provided by (Used for) Operating Activities		
Change in Net Assets	95,886,591	(6,929,746)
Adjustments to Reconcile Change in Net Assets to Net Cash Provided by (Used for) Operating Activities		
Depreciation	410,496	517,800
Amortization	2,093,322	1,461,828
Security Lending Costs	394,677	1,450,072
Security Lending Income	(950,244)	(3,379,067)
Income on Investments	(120,518,771)	(17,305,580)
Payments of Dividends to Policyholders	2,001,293	3,996,599
Decrease (Increase) in		
Accounts Receivable	4,054,866	9,550,208
Due from Component Units of the State of Montana	433,661	79,363
Due from Primary Government	-	3,009
Notes Receivable	-	-
Other Assets	1,604,969	(12,112,407)
Increase (Decrease) in		
Accounts Payable	10,193,310	(7,649,738)
Due to Primary Government	(1,295,253)	(257,272)
Deferred Revenue	(4,497,353)	(3,823,859)
Property Held in Trust	(630,075)	11,084,420
Funds Withheld	(1,691,126)	-
Estimated Claims Payable	25,460,628	61,051,413
OPEB Liability	808,837	894,689
Compensated Absences	31,963	130,297
Total Adjustments	(82,094,800)	45,691,775
Net Cash Provided by (Used for) Operating Activities	13,791,791	38,762,029

The notes to the financial statements are an integral part of this statement.

STATE OF MONTANA - OLD FUND
STATEMENT OF NET ASSETS
Montana State Fund is a component unit of the State of Montana

June 30,	2010	2009
ASSETS		
Current Assets		
Cash and Cash Equivalents	$ 6,106,711	$ 13,268,383
Receivables, Net	71,724	133,928
Due from Montana State Fund	-	26,633
Securities Lending Collateral	1,336,139	1,568,726
Total Current Assets	7,514,574	14,997,671
Noncurrent Assets		
Investments	4,167,029	7,373,884
Total Noncurrent Assets	4,167,029	7,373,884
Total Assets	$ 11,681,603	$ 22,371,556
LIABILITIES		
Current Liabilities		
Accounts Payable	$ 408,828	$ 173,970
Due to Primary Government	109,856	209
Due to Montana State Fund	-	548,649
Estimated Claims Payable	9,842,070	10,974,661
Securities Lending Liability	1,336,139	1,568,726
Total Current Liabilities	11,696,893	13,266,215
Noncurrent Liabilities		
Estimated Claims Payable	48,152,034	54,599,881
Total Noncurrent Liabilities	48,152,034	54,599,881
Total Liabilities	59,848,927	67,866,096
NET ASSETS		
Unrestricted	(48,167,324)	(45,494,540)
Total Net Assets	(48,167,324)	(45,494,540)
Total Liabilities and Net Assets	$ 11,681,603	$ 22,371,556

The notes to the financial statements are an integral part of this statement.

STATE OF MONTANA - OLD FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
Montana State Fund is a component unit of the State of Montana

YEAR ENDED JUNE 30,	2010	2009
Operating Expenses		
Benefits and Claims	$ 1,783,124	$ 8,265,086
Personal Services	1,518	7,448
Contractual Services	771,100	1,038,661
Depreciation	20,466	31,393
Amortization	104,367	88,627
Other Operating Expenses	216,733	122,382
Total Operating Expenses	2,897,308	9,553,596
Operating Income (Loss)	(2,897,308)	(9,553,596)
Nonoperating Revenue(Expenses)		
Investment Income	221,036	529,155
Securities Lending Income	5,877	77,421
Securities Lending Expenses	(2,389)	(35,728)
Total Nonoperating Revenue(Expenses)	224,524	570,848
Change in Net Assets	(2,672,784)	(8,982,748)
Total Net Assets - Beginning	(45,494,540)	(36,511,792)
Total Net Assets - Ending	$ (48,167,324)	$ (45,494,540)

The notes to the financial statements are an integral part of this statement.

State of Montana - Old Fund
Statement of Cash Flows
Montana State Fund is a component unit of the State of Montana

YEAR ENDED JUNE 30,	2010	2009
Cash Flows from Operating Activities		
Payments to Suppliers for Goods and Services	(1,649,159)	(1,535,149)
Payments to Employees		111,427
Payments for Claims	(9,128,746)	(10,993,712)
Other Operating Receipts	156,687	
Net Cash Used for Operating Activities	(10,621,218)	(12,417,434)
Cash Flows from Investing Activities		
Purchase of Investments	779,470	71,128
Proceeds from Sales or Maturities of Investments	2,344,870	12,538,565
Proceeds from Securities Lending Transactions	5,877	76,907
Payments of Security Lending Costs	(2,347)	(41,126)
Interest and Dividends on Investments	331,676	657,036
Net Cash Provided by Investing Activities	3,459,546	13,302,509
Net Decrease in Cash and Cash Equivalents	(7,161,672)	885,075
Cash and Cash Equivalents - July 1	13,268,383	12,383,308
Cash and Cash Equivalents - June 30	6,106,711	13,268,383

The notes to the financial statements are an integral part of this statement.

State of Montana - Old Fund
Statement of Cash Flows
Montana State Fund is a component unit of the State of Montana

YEAR ENDED JUNE 30,	2010	2009
Reconciliation of Change in Net Assets to Net Cash Used for Operating Activities		
Change in Net Assets	(2,672,784)	(8,982,748)
Adjustments to Reconcile Change in Net Assets to Net Cash Used for Operating Activities		
Security Lending Costs	2,389	35,213
Security Lending Income	(5,877)	(76,907)
Interest on Investments	(221,036)	(529,155)
Decrease (Increase) in		
Accounts Receivable	33,872	(51,156)
Due from Primary Government	26,633	85,170
Other Assets		-
Increase (Decrease) in		
Accounts Payable	235,028	28,671
Due to Montana State Fund	(439,002)	(66,154)
Due to Primary Government		-
Estimated Claims	(7,580,441)	(2,860,369)
Total Adjustments	(7,948,434)	(3,434,686)
Net Cash Used for Operating Activities	(10,621,218)	(12,417,434)

The notes to the financial statements are an integral part of this statement.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2010 and 2009

1. Summary of Significant Accounting Policies

Description of Business

The Montana State Fund (MSF) is a nonprofit, independent public corporation established under Title 39, chapter 71 of the Montana Code Annotated (MCA). MSF provides Montana employers with an option for workers' compensation and occupational disease insurance and guarantees available coverage for all employers in Montana. MSF is governed by a seven member Board of Directors appointed by the Governor. The Board has full power, authority, and jurisdiction in the administration of MSF as fully and completely as the governing body of a private mutual insurance carrier. MSF is attached to the State of Montana, Department of Administration for administrative purposes only.

During the 1990 Montana Special Legislative Session, legislation passed establishing separate funding and accounts for claims of injuries resulting from accidents occurring before July 1, 1990, referred to as the Old Fund, and claims occurring on or after July 1, 1990, referred to as MSF. Hereafter, any reference to MSF refers to the New Fund or those claims occurring after July 1, 1990.

MSF functions as an autonomous insurance entity supported solely from its own revenues. All assets, debts, and obligations of MSF are separate and distinct from assets, debts, and obligations of the State of Montana. No State of Montana General Fund money is used for MSF operations.
If MSF is dissolved by an act of law, the assets held by MSF are subject to the disposition provided by the legislature enacting the dissolution with due regard given to obligations incurred and existing (Section 39-71-2322, MCA). Under Section 39-71-2352 MCA, the Old Fund is a liability of the State of Montana and if at any time the Old Fund is not adequately funded, amounts necessary to pay claims of the Old Fund must be transferred from the General Fund. MSF administers and manages the claims remaining in the Old Fund for the State of Montana and is the administering entity for recording the financial activity related to receipt and disbursement of funds and assets held by the Old Fund.

MSF and Old Fund financial statements are presented as a component unit in the State of Montana Comprehensive Annual Financial Report. The fiscal year 2010 and 2009 financial statements are presented in conformance with generally accepted accounting principles (GAAP), and Governmental Accounting Standards Board Statement 34 (GASB), which is a comparable format to the State of Montana Comprehensive Annual Financial Report.

Basis of Accounting

MSF and the Old Fund use the accrual basis of accounting, as defined by generally accepted accounting principles, for their workers' compensation insurance operations. Under the accrual basis, revenues are recorded in the accounting period earned, if measurable, and expenses are recorded in the period incurred, if measurable.

Cash and Cash Equivalents

Cash balances include demand deposits with the State Treasury. Cash equivalents are short-term, highly liquid investments that are both readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. MSF and the Old Fund participate in the Montana Board of Investments Short Term Investment Pool (STIP). STIP balances are highly liquid investments with maturities of 397 days or less with the exception of securities having rate reset dates. The STIP portfolio is carried at amortized cost or book value with market value approximating cost. MSF's STIP balance of $22.8M (million) as of June 30, 2010, represents 1.01% of the total STIP. The Old Fund STIP balance of $5.5M as of June 30, 2010, represents 0.25% of the total STIP. MSF's STIP balance of $24.2M as of June 30, 2009, represents 1.05% of the total STIP. The Old Fund STIP balance of $12.5M as of June 30, 2009, represents 0.54% of the total STIP.

The STIP investments' credit risk is measured by investment grade ratings given individual securities. The Montana Board of Investment's (BOI) policy requires that STIP investments have the highest rating in the short-term category by one of any Nationally Recognized Statistical Rating Organizations (NRSRO). The three NRSRO's include Standard and Poor's, Moody's Investors Service, and Fitch, Inc.

Investments

In addition to STIP investments, the BOI invests in long-term securities. Under the provisions of the state constitution, MSF and the Old Fund's invested assets are managed by the BOI. Securities are stated at fair value as defined and required by Governmental Accounting Standards Board (GASB) Statement 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools". Premiums and discounts are amortized using the straight-line method over the life of the securities. Net unrealized gains or losses on securities are included in net income in accordance with GASB 31.

The BOI follows the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. government securities, the State Fund fixed income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed income security may default in making timely principal and interest payments. The Board of Investments' policy requires New Fund fixed income investments, at the time of purchase, to be rated investment grade as defined either by Moody's or by Standard & Poor's (S&P) rating services. The investment policy, revised in May 2010, states "the maximum fixed income credit risk will be limited to 2% of the total securities portfolio in any one name". The U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the following table are provided by S&P's rating services. If an S&P rating is not available, a Moody's rating has been used.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2010 and 2009, all the fixed income and other equity securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank, State Street Bank. The Equity Index investments were purchased in the State of Montana Board of Investments name.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a investment in a single issuer. The New Fund Investment Policy, requires credit risk to be limited to 2 percent in any one corporate name with no limitation on U.S. government/agency securities. Investments issued or explicitly guaranteed by the U.S. government are excluded from the concentration of credit risk requirement.

For fiscal year 2010, New Fund had concentration of credit risk exposure of 6.67% with Federal Home Loan Banks and 5.71% to the Federal National Mortgage Association (Fannie Mae). The New Fund fiscal year 2009 concentration of credit risk is stated as 7.05% - Federal Home Loan Banks, 10.39% - Federal National Mortgage Association (Fannie Mae) and 8.77% - Federal Home Loan Mortgage Corp. (Freddie Mac).

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2010 and 2009

For fiscal year 2010, Old Fund had concentration of credit risk exposure to the, Commercial Mortgage Trust of 5.99%, and Verizon New Jersey of 10.91%. The Old Fund fiscal year 2009 concentration of credit risk is stated as 7.38% - Commercial Mortgage Trust.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The New Fund policy sets an average duration range of 2-5 years for fixed income securities except in extraordinary circumstances where a shorter duration may be advisable. In accordance with GASB Statement No. 40, the Board has selected the effective duration method to disclose interest rate risk. This method is "An option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates. Duration is defined as the average percentage change in a bond's price for a given change in interest rates. Prices move inversely to interest rates. The effective duration method incorporates the effect of the embedded options for bonds and changes in prepayments for mortgage-backed securities (including pass-through's, CMOs and ARMs)."

As of June 30, 2010, the State Fund held one $10 million par Collateralized Debt Obligations (CDO) variable rate position in Aria II, 2.130%, October 10, 2012. A CDO is a security backed by a pool of bonds, loans or other assets. CDOs do not specialize in one type of debt but are often non-mortgage loans or bonds. A $4 million par CDO variable rate position in Galena 1, 5.060%, January 11, 2013, held as of June 30, 2009, was sold in May 2010. The New Fund and Old Fund portfolios did not hold any structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits).

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, or other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

As of June 30, 2010 and 2009, the New Fund portfolio held three variable rate corporate bonds with $26 million par and $19 million par, respectively. The New Fund variable-rate securities float with LIBOR (London Interbank Offered Rate).

New Fund and Old Fund investments are categorized below to disclose credit and interest rate risk as of June 30, 2010 and June 30, 2009. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Interest rate risk is disclosed using effective duration. Both the credit quality ratings and duration have been calculated excluding cash equivalents.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2010 and 2009

Montana State Fund - Credit Quality Rating and Effective Duration as of June 30, 2010

Security Investment Type		Fair Value	Credit Quality Rating	Effective Duration
Corporate Bonds (Rated)	$	597,746,801	A	3.41
U.S. Government Direct Obligations		156,683,829	AAA	5.19
U.S. Government Agency		235,734,987	AAA	3.53
SIVs (Unrated)		1,460,026	NR	0.11
STIP (Unrated)		22,753,534	NR	0.11
Total Fixed Income Investments		1,014,379,177		
Direct Investments				
Equity Index Fund-Domestic		106,976,749		
Equity Index Fund-International		3,813,440		
Total Equity Index Funds		110,790,189		
Total Direct Investments	$	110,790,189		
Total Investments	$	1,125,169,366	AA-	3.63

Old Fund - Credit Quality Rating and Effective Duration as of June 30, 2010

Security Investment Type		Fair Value	Credit Quality Rating	Effective Duration
Corporate Bonds (Rated)	$	1,636,151	AA-	0.95
U.S. Government Direct Obligations		1,869,203	AAA	1.59
U.S. Government Agency		307,834	AAA	1.10
SIVs (Unrated)		353,842	NR	0.11
STIP (Unrated)		5,514,397	NR	0.11
Total Investments	$	9,681,427	AA+	0.57

Legal Risk

As of June 30, 2010 and 2009, the Federal National Mortgage Association and Federal Home Loan Mortgage Corp. remain in conservatorship from September 7, 2008. On September 15, 2008, Lehman Brothers filed for bankruptcy protection. The State Fund holds two positions of Lehman Brothers Holdings, Inc., $5 million par, 0.0%, May 25, 2010 and $4 million par, 5%, 01/14/2011. Lehman Brothers filed for Chapter 11 bankruptcy on September 15, 2008. During fiscal year 2009, the BOI wrote down the par value of these bonds. As of June 30, 2010 and 2009, these securities were written down to a book value of 20% of their original par value.

On October 30, 2008, the BOI recognized collateral deterioration in the $4 million par position with the Galena CDO, 5.060%, January 11, 2013. As of June 30, 2009, this security was written down to a book value of 10% of its original par. In May 2010, this security was sold at a bond price of $36, resulting in a realized gain of $1.0M for the year ending June 30, 2010.

The MSF and Old Fund investments are classified in risk Category 1 or as Not Categorized under State of Montana standards. Risk category 1 includes investments that are insured or registered, or securities held by the BOI or its agent in the BOI's name. Not Categorized includes investments held by broker-dealers under securities loans with cash collateral.

The following table presents the market values of the securities on loan and the total collateral held for fiscal years ended June 30, 2010 and June 30, 2009 for both MSF and the Old Fund:

	MSF		**Old Fund**	
	2010	**2009**	**2010**	**2009**
Securities on Loan - Market Value	322,786,743	329,537,940	1,086,756	1,535,742
Total Collateral Held	330,199,605	338,295,564	1,336,139	1,568,726

Income earned related to securities on loan for MSF and the Old Fund for the fiscal year ended June 30, 2010 was $950K (thousand) and $6K, respectively. Expenses related to securities on loan for MSF and the Old Fund for the fiscal year ended June 30, 2010 was $395K and $2K, respectively.

Income earned related to securities on loan for MSF and the Old Fund for the fiscal year ended June 30, 2009 was $3.4M and $77K, respectively. Expenses related to securities on loan for MSF and the Old Fund for the fiscal year ended June 30, 2009 were $1.5M and $36K, respectively.

MSF is allowed by Montana Constitution to invest in equity securities, with the restriction that equity securities cannot exceed 25% of total investment book value. The BOI policy for MSF

maintains equities in the 8% to 12% range. As of June 30, 2010, equity securities in MSF include $102.4M at cost, enhanced by $8.4M in market value appreciation. As of June 30, 2009, equity securities in MSF include $84.4M at book value, reduced by $2.7M in market value depreciation.

Additional investment information can be found in Note 2.

Receivables

The receivable for unbilled premium was established for fiscal year 2010 and fiscal year 2009 (restated) financial statements. The restatement was due to a correction of an error, since MSF was not recording written premium correctly using this unbilled premium receivable.

Also, the receivable for retrospective premium was established for fiscal year 2010.

At June 30, 2010, MSF had a net receivable balance of $64.0M. The billed premium receivable and claim benefit recoveries balance is $10.1M, which is then reduced by the estimated uncollectible receivables reported as an allowance for doubtful accounts of $2.5M. Other receivables include $44.7M in unbilled premium, $10.7M in investment income due, $762K in retrospective premium and $196K in notes and loans receivable, all of which is short term.

At June 30, 2009, MSF had a net receivable balance of $68.6M (restated to establish unbilled premium receivable). The billed premium receivable and claim benefit recoveries balance is $11.7M, which is then reduced by estimated uncollectible receivables reported as an allowance for doubtful accounts of $3.4M. Other receivables include $48.9M in unbilled premium, $11.2M in investment income due and $199K in notes and loans receivable, all of which is short term.

Accounts receivable includes $691K at June 30, 2010 and $6.2M at June 30, 2009 for premium that has been earned but unbilled (EBUB).

Accounts receivable in the Old Fund include medical and indemnity overpayments and interest receivable. Old Fund accounts receivable for year ended June 30, 2010 and June 30, 2009 were $1.0M and $1.2M, respectively. Estimated uncollectible receivables are reported as an allowance for doubtful accounts and are recorded at $969K and $1.1M for the years ended June 30, 2010 and June 30, 2009 respectively. Interest receivable of $64K at June 30, 2010 and $93K at June 30, 2009 represent investment income due.

Equipment, Accumulated Depreciation and Intangible Assets

Equipment is capitalized if the actual or estimated historical cost exceeds $5K. Depreciation expense is computed on a straight-line basis for equipment over a period of three to five years and amortization of intangible assets is computed on a straight-line basis over five years. Amortization of intangible assets is applied directly to the asset balance. All fixed assets are recorded in the MSF financials and shown net of depreciation. Because MSF administers the Old Fund, the Old Fund does not carry fixed assets.

Other Assets

Other assets include advances, prepaid expenses and deferred acquisition costs. Deferred acquisition costs are amounts incurred during the policy writing process that are recognized ratably over the related policy term.

Reinsurance receivable balances were reclassified from current assets under Other Assets to a non-current asset and reflect estimated amounts owed to MSF in future years under reinsurance contracts. This reclassification was a correction of an error since MSF included the reinsurance receivable as a current asset in the prior year financials when it should have been a non-current asset.

During June of 2010, MSF completed construction of an office building that it now occupies. MSF pays all costs of the property including utilities, property assessments, janitorial services, and maintenance. For the fiscal year ended June 30, 2010, MSF financial statements include $1.14M in land and $27.8M in buildings. Prior to occupying the new building, MSF leased an office building from the State of Montana and other office space in Helena. That lease expired on July 31, 2010.

Estimated Claims Payable

The estimated claims payable is established to provide for the estimated ultimate settlement cost of all claims incurred. Estimated claims payable is based on reported aggregate claim cost estimates combined with estimates for future development of such claim costs and estimates of incurred but not reported (IBNR) claims. Towers Watson, an external actuarial firm, prepares an actuarial study that provides a range of potential costs associated with reported claims, the future development of those claims and IBNR. MSF management has selected central estimates within that range as the estimated claims payable for MSF and has used the Towers Watson best estimate for the estimated claims payable for the Old Fund. For additional disclosure related to the estimated claims payable, refer to Note 4.

Accounts Payable

Accounts payable is a short term liability account reflecting amounts owed for goods and services received by MSF.

Unearned Premium

Unearned premium reflects premium that has been written but not yet earned. The unearned premium was $47M at June 30, 2010 and $52M at June 30, 2009 (restated). The restatement was due to a correction of an error since MSF was not recording written premium correctly using the unearned premium liability account.

Policyholder Deposits

Policyholder deposits consist of security deposits owed to policyholders that are required to have a deposit policy and choose to pay cash to secure the policy.

Reinsurance Funds Withheld

Reinsurance funds withheld represents the reinsurance funds held on behalf of the reinsurer, a requirement of MSF's aggregate stop loss reinsurance contract. Additional information regarding the funds withheld account can be found in Note 3.

Net Assets

Net assets consist of the net excess or deficit of assets over liabilities. For additional information on distributions impacting total net assets see Note 6.

Premiums

The MSF Board of Directors approves premium rates annually. Generally, policies are effective for the term of the policy period not to exceed 12 months. Premium revenue is recognized over the term of the fiscal year, which runs from July 1 through June 30, as it is earned or when MSF is liable for coverage.

Policyholders are contractually obligated to pay certain premiums to MSF in advance of the period the premiums are earned. Premium advances are refundable when the policyholder's coverage is canceled and all earned premiums have been credited by MSF.

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Basis of Presentation

The financial statements are presented in accordance with generally accepted accounting principles as prescribed by the GASB. MSF and Old Fund insurance operations are classified as an enterprise fund, proprietary fund type. MSF and Old Fund comprises only a part of the State of Montana's enterprise funds. The financial statements in this report reflect the financial position and results of operations and cash flows of MSF and the Old Fund.

An enterprise fund is used to account for operations: (a) financed and operated in a manner similar to private business enterprises, where the legislature intends that the entity finance or recover costs primarily through user charges; (b) where the legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate; (c) where the activity is financed solely by a pledge of the net revenues from fees and charges of the activity; or (d) when laws or regulations require that the activities' costs of providing services be recovered with fees and charges rather than with taxes or similar revenues.

Investments are presented in accordance to GASB Statement Number 31, "Accounting and Financial Reporting for Certain Investments and External Investment Pools." STIP is considered an external investment pool, which is defined as an arrangement that pools the monies of more than one legally separate entity and invests, on the participant's behalf, in an investment portfolio. STIP is also classified as a "2a7-like" pool. A 2a7-like pool is an external investment pool that is not registered with the Securities and Exchange Commission (SEC) as an investment company, but has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. If certain conditions are met, 2a7-like pools are allowed to use amortized cost rather than fair value to report net assets to compute unit values. The BOI has adopted a policy to treat STIP as a 2a7-like pool. See Note 1, Basis of Accounting – Investments and Note 2 for further discussions of the effect of GASB 31.

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2. Investments

The amortized cost and market value of MSF's fixed maturity and equity securities as of June 30, 2010, and June 30, 2009, are as follows:

		Gross Unrealized		
June 30, 2010	Amortized Cost	Gain	Loss	Market Value
Government Direct-Indirect	$ 351,190,011	$ 28,435,572	$ -	$ 379,625,583
Government Mortgage-Backed	39,680,185	2,860,876	-	42,541,061
Corporate Securities Asset-Backed	54,542,436	2,330,402	2,554,874	54,317,964
Other Corporate Securities	482,296,988	31,761,806	377,784	513,681,010
Other Securities	1,460,026	-	-	1,460,026
Equity Securities	102,406,677	8,570,072	186,560	110,790,189
STIP	22,753,534	-	-	22,753,534
Total	$ 1,054,329,856	$ 73,958,728	$ 3,119,218	$ 1,125,169,366

		Gross Unrealized		
June 30, 2009	Amortized Cost	Gain	Loss	Market Value
Government Direct-Indirect	$ 338,506,185	$ 18,421,356	$ 1,096,593	$ 355,830,948
Government Mortgage-Backed	55,021,462	2,170,681	-	57,192,143
Corporate Securities Asset-Backed	67,844,154	817,761	12,999,051	55,662,864
Other Corporate Securities	448,365,867	9,504,796	17,274,167	440,596,496
Other Securities	2,196,735	-	-	2,196,735
Equity Securities	84,406,677	-	2,663,771	81,742,906
STIP	24,207,449	-	-	24,207,449
Total	$ 1,020,548,529	$ 30,914,595	$ 34,033,583	$ 1,017,429,540

The amortized cost and estimated market value of MSF's fixed maturity securities as of June 30, 2010 and June 30, 2009 are shown below at contractual maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

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June 30, 2010

	Amortized Cost	Market Value
Due one year or less	$ 90,335,353	$ 91,940,611
Due after one year through five years	462,617,747	486,053,179
Due after five years through ten years	343,845,184	377,809,278
Due after ten years	55,124,896	58,576,110
Equity Securities	102,406,677	110,790,189
Total	$ 1,054,329,856	$ 1,125,169,366

June 30, 2009

	Amortized Cost	Market Value
Due one year or less	$ 50,409,071	$ 49,248,619
Due after one year through five years	385,090,036	382,973,275
Due after five years through ten years	394,248,043	401,097,674
Due after ten years	106,394,702	102,367,067
Equity Securities	84,406,677	81,742,906
Total	$ 1,020,548,529	$ 1,017,429,540

During the fiscal year ending June 30, 2010, MSF realized gross gains from sales of securities of $2.8M and gross realized losses of ($663K). During the fiscal year ending June 30, 2009, MSF realized gross gains from sales of securities of $1.57M and gross realized losses of ($15.2M).

As discussed in Note 1, GASB 31 requires governmental entities to report their investments at fair value. Fair value is defined as the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The adjustment to fair value is reflected as an increase or decrease in investment income. During fiscal year 2010, investment income for MSF reflects an increase of $103.2M primarily due to the unrealized gain on investments in the amount of $74.0M. Investment income for fiscal year 2009 reflects a decrease of ($15.6M) primarily due to the unrealized loss on investments of ($15.1M).

The amortized cost and market value of the Old Fund fixed maturity securities as of June 30, 2010 and June 30, 2009 are as follows:

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June 30, 2010	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Market Value
Government Direct-Indirect	$ 1,817,000	$ 52,202	$ -	$ 1,869,202
Government Mortgage-Backed	284,194	23,641	-	307,834.15
Corporate Securities Asset-Backed	578,384	1,851	-	580,235.30
Other Corporate Securities	1,008,314	47,601	-	1,055,915.60
Other Securities	353,842	-	-	353,842.00
STIP	5,514,397	-	-	5,514,397.06
Total	$ 9,556,131	$ 125,295	$ -	$ 9,681,427

June 30, 2009	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Market Value
Government Direct-Indirect	$ 2,726,000	$ 115,610	$ -	$ 2,841,610
Government Mortgage-Backed	487,945	28,044	-	515,989
Corporate Securities Asset-Backed	1,810,580	10,486	-	1,821,066
Other Corporate Securities	1,013,685	48,224	-	1,061,909
Other Securities	1,133,310	-	-	1,133,310
STIP	12,488,783	-	-	12,488,783
Total	$ 19,660,305	$ 202,364	$ -	$ 19,862,668

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The amortized cost and market value of the Old Fund fixed maturity securities as of June 30, 2010 and June 30, 2009 are shown below at contractual maturity. All Old Fund securities are expected to be sold at market values prior to maturity dates to fund claim benefit payments.

June 30, 2010

	Amortized Cost	Market Value
Due one year or less	$ 5,868,239	$ 5,868,239
Due after one year through five years	3,109,508	3,232,952
Due after five years through ten years	-	-
Due after ten years	578,384	580,235
Total	$ 9,556,131	$ 9,681,427

June 30, 2009

	Amortized Cost	Market Value
Due one year or less	$ 13,622,093	$ 13,622,093
Due after one year through five years	4,227,631	4,419,508
Due after five years through ten years	-	-
Due after ten years	1,810,580	1,821,066
Total	$ 19,660,305	$ 19,862,668

During the fiscal year ended June 30, 2010, the Old Fund realized $8K in gross gains from sales of securities and ($3K) in gross losses from sales of securities. During the fiscal year ended June 30, 2009, the Old Fund realized less than $1K in gross gains from sales of securities and ($266K) in gross losses from sales of securities.

During fiscal year 2010, Old Fund investment income included an unrealized losses in the amount of ($77K) in its long-term portfolio. Old Fund investment income for fiscal year 2009 included an unrealized gain in the amount of $75K in its long-term portfolio.

3. Reinsurance

For the fiscal years ended June 30, 2010 and June 30, 2009, MSF ceded premiums to other reinsurance companies to limit the exposure arising from large losses. These arrangements consist of excess of loss contracts that protect against individual occurrences over stipulated amounts and an aggregate stop loss contract which protects MSF against the potential that aggregate losses will exceed expected levels expressed as a percentage of premium.
The excess of loss contracts provide coverage for fiscal years 2010 and 2009, respectively, as follows:

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Contract Period	Reinsurance Coverage
2010	Workers' compensation accidents of up to $5M in excess of $5M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $20M in excess of $10M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $70M in excess of $30M, maximum of $5M per any one claimant.
2009	Workers' compensation accidents of up to $5M in excess of $5M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $20M in excess of $10M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $70M in excess of $30M, maximum of $5M per any one claimant.

The term of the current aggregate stop loss contract is July 1, 2008 through June 30, 2011. The contract provides coverage based on MSF's premium levels at a maximum of $45M per year and a minimum of $36.6M, but in aggregate not to exceed 100.0% of the sum of the annual limits for all contract years. In the event reinsurers are unable to meet their obligations under either the excess of loss contracts or aggregate stop loss contract, MSF would remain liable for all losses, as the reinsurance agreements do not discharge MSF from its primary liability to the policyholders.

Premium revenue is reduced by premiums paid for reinsurance coverage of $13.2M and $13.7M in fiscal years 2010 and 2009, respectively. The aggregate stop loss contract requires that MSF maintain a funds-withheld account which represents the basic premium portion of the total premium paid for aggregate stop loss coverage. The total funds withheld account at June 30, 2010 is $64.2M for contracts in place from July 1, 2002 to June 30, 2010. The funds withheld account at June 30, 2009 was $51.9M for contracts in place from July 1, 2002 to June 30, 2009. Interest must be accrued on the funds withheld account which resulted in accrued interest of $3.2M for fiscal year 2010 and $2.6M for fiscal year 2009.

Estimated claim reserves were reduced by $7.4M and $7.3M for fiscal years 2010 and 2009 respectively for the amount of reinsurance estimated to be ultimately recoverable on incurred losses due to the excess of loss reinsurance contract. In fiscal year 2010 estimated

claim reserves were reduced by an additional $12.0M and in fiscal year 2009 an additional $10.7M for the amount of reinsurance estimated to be ultimately recoverable on incurred losses due to the aggregate stop loss contract.

MSF also has assumed reinsurance relationships with Argonaut Insurance Company and Legion Insurance Company related to Other States Coverage (OSC). MSF assumes risk related to Montana domiciled businesses with operations in other states, which are then covered under MSF's ceded reinsurance contract. Assumed premium for fiscal years 2010 and 2009 is $1.6M and $2.7M, respectively. The incurred losses from OSC benefits was $453K and $711K for fiscal years 2010 and 2009, respectively. The assumed liability for OSC claims is $5.2M and $4.6M for fiscal years 2010 and 2009, respectively.

4. Risk Management

MSF provides liability coverage to employers for injured employees that are insured under the Workers' Compensation and Occupational Disease Acts of Montana. Workers' compensation claims occurring on or after July 1, 1990, are reported in the MSF financials. At June 30, 2010, approximately 25,253 active policies were insured by MSF. At June 30, 2009, approximately 26,398 active policies were insured by MSF.

MSF is a self-supporting, competitive state fund and functions as the guaranteed market insurer for employers since workers' compensation insurance is mandatory in Montana. Employers may obtain coverage through private carriers, through MSF or through self-insurance if they meet certain criteria. Public entities may self-insure or insure through MSF.

Montana State Fund serves as claim administrator on claims for injuries that occurred before July 1, 1990, known as the State of Montana (Old Fund). When the reserves in the Old Fund become inadequate, the State of Montana and General Fund will be obligated to cover benefit payments and administrative costs. Unpaid claims and claims adjustment expenses are estimated based on the ultimate cost of settling the claims including the effects of inflation and other social and economic factors. When MSF purchases annuity contracts, the claim is settled in full and on a final basis, and all liability of MSF is terminated.

Towers Watson, an external actuarial firm, prepares an actuarial study used to estimate liabilities and the ultimate cost of settling claims reported but not settled and claims incurred but not reported (IBNR) for MSF as of June 30, 2010 and June 30, 2009. Because actual claim costs depend on such complex factors such as inflation and changes in the law, claim liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. A provision for inflation is implicit in the calculation of

estimated future claim costs because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience.

Towers Watson provides a range of potential costs associated with reported claims, the future development of those claims and IBNR. MSF management has selected a central estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2010 and 2009. The MSF estimated unpaid claims and claims adjustment expenses payable is presented at face value, net of estimated reinsurance recoverable, at $838.8M and $813.3M, as of June 30, 2010 and June 30, 2009, respectively. The estimated claims payable increased $25.5M from 2009 to 2010, which includes additional development of approximately $13.8M on prior year claims. MSF currently has no knowledge of any significant environmental or asbestos claims that would contribute to this estimate.

State law (Section 39-71-2311, MCA) requires MSF to set premiums at least annually at a level sufficient to ensure adequate funding of the insurance program during the period the rates will be in effect. Anticipated investment income is considered when computing premium rate levels. State law also requires the MSF Board of Directors to establish surplus above risk based capital requirements to secure MSF against risks inherent in the business of insurance.

Acquisition costs represent costs associated with the acquisition of new insurance contracts or renewal of existing contracts and include agent commissions and expenses incurred in the underwriting process. MSF acquisition costs are capitalized and amortized ratably over the subsequent year. Capitalized acquisition costs at June 30, 2010 and June 30, 2009 are $4.4M and $4.6M, respectively. For the years ended June 30, 2009 and June 30, 2008, acquisition costs that were amortized are $4.6M and $5.1M, respectively.

The Old Fund covers the liability and payment of workers' compensation claims for incidents occurring before July 1, 1990. Funding for claims payments in the Old Fund is provided by the assets and investment earnings from those assets. If the assets held by the Old Fund are not adequate to fund claim payments and the administration of the Old Fund, the State of Montana and the state General Fund must fund future claims payments. The Old Fund assets are expected to be fully liquidated prior to fiscal year ending June 30, 2011.

An actuarial study prepared by Towers Watson for the Old Fund as of June 30, 2010 and June 30, 2009, is used to estimate liabilities and the ultimate cost of settling claims that have been reported, but not settled, and claims that have been incurred, but not reported (IBNR). Towers Watson provides a range of potential costs associated with reported claims, the

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future development of those claims and IBNR. MSF management has selected the central estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2010 and 2009. As of June 30, 2010, the undiscounted estimated claims payable is $71.1M and is presented at net present value of $58.0M discounted at a 3.5% rate. As of June 30, 2009, the undiscounted estimated claims payable was $79.2M and presented at net present value of $65.6M discounted at a 3.5% rate.

Changes in Claims Liabilities for the Past Two Years

The following table presents changes in the aggregate liabilities for MSF and the Old Fund for the past two years, net of estimated reinsurance recoverable. The information presented has not been discounted.

	MSF	
	2010	**2009**
Unpaid claims and claim adjustment expenses at beginning of year	$ 813,304,712	$ 752,253,300
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current year	144,893,281	151,964,493
Increase(Decrease) in provision for events in prior years	8,201,572	30,842,102
Total incurred claims and claim adjustment expenses	153,094,853	182,806,595
Payments:		
Claims and claim adjustment expenses attributable to insured events of CY	(25,477,518)	(28,062,156)
Claims and claim adjustment expenses attributable to insured events of PY	(102,156,707)	(93,693,027)
Total payment	(127,634,225)	(121,755,183)
Total unpaid claims and claim adjustment expenses at end of the year	$ 838,765,340	$ 813,304,712

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	Old Fund (Undiscounted)	
	2010	**2009**
Unpaid claims and claim adjustment expenses at beginning of year	$ 79,162,697	$ 86,732,627
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current year	-	-
Increase(Decrease) in provision for events in prior years	1,102,507	3,170,707
Total incurred claims and claim adjustment expenses	1,102,507	3,170,707
Payments:		
Claims and claim adjustment expenses attributable to insured events of CY	-	-
Claims and claim adjustment expenses attributable to insured events of PY	(9,128,746)	(10,740,637)
Total payment	(9,128,746)	(10,740,637)
Total unpaid claims and claim adjustment expenses at end of the year	$ 71,136,458	$ 79,162,697

Risk Management Trend Information

The following table illustrates how the earned revenues of MSF plus investment income compare to related costs of loss and other expenses assumed by MSF for fiscal years 2001 through 2010. In addition, cumulative amounts related to estimated and actual paid claims are presented. The information allows for comparison of actual and estimated claims and is a basis for developing revenue and claims information. As data for individual policy years mature, the correlation between original estimates and re-estimated amounts is used to evaluate the accuracy of incurred claims currently recognized for less mature policy years.

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(In Millions's)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
1. Premiums and Investment Revenue										
Earned	116,189	123,888	162,869	171,537	230,818	252,330	290,047	272,073	237,553	197,337
Ceded	2,952	(465)	5,654	6,563	6,788	13,618	14,856	14,676	13,702	13,224
Net Earned	113,237	124,353	157,216	164,974	224,030	238,713	275,191	257,397	223,850	184,113
2. Unallocated expenses including overhead	26,188	28,713	31,548	37,569	39,078	40,548	41,947	47,778	49,215	44,188
3. Estimated losses and expenses, end of accident year										
Incurred	68,267	81,560	110,153	120,705	134,290	155,057	170,652	177,100	159,229	137,507
Ceded	-	-	-	-	-	-	-	-	-	-
Net Incurred	68,267	81,560	110,153	120,705	134,290	155,057	170,652	177,100	159,229	137,507
4. Net paid (cumulative) as of:										
End of policy year	14,140	16,693	22,982	26,123	25,721	30,977	32,708	31,002	29,009	25,475
One year later	32,888	38,185	48,861	50,888	57,239	66,063	67,928	67,034	60,009	
Two years later	45,218	52,359	63,773	66,140	72,229	84,014	85,646	86,268		
Three years later	55,248	60,029	72,957	74,697	82,647	94,091	98,427			
Four years later	61,846	64,922	79,060	80,233	88,236	100,189				
Five years later	66,031	68,343	84,340	83,788	93,682					
Six years later	69,553	71,566	88,645	86,707						
Seven years later	72,367	74,253	89,482							
Eight years later	75,269	75,036								
Nine years later	76,730									
5. Re-estimated ceded losses and expenses	335	-	8,600	3,376	-	-	-	-	-	-
6. Re-Estimated net incurred losses and expense:										
End of policy year	68,267	81,560	110,153	120,705	134,290	155,057	170,652	177,100	159,229	137,507
One year later	71,094	86,799	110,532	112,609	136,235	157,711	171,783	174,279	152,886	
Two years later	81,053	91,241	112,443	124,413	138,447	163,433	170,786	173,808		
Three years later	88,157	94,615	117,245	127,827	144,484	164,358	172,038			
Four years later	92,329	99,755	115,414	129,051	143,820	165,313				
Five years later	95,727	100,925	119,976	127,702	145,839					
Six years later	98,124	105,651	121,686	127,054						
Seven years later	102,847	104,874	120,020							
Eight years later	103,475	103,261								
Nine years later	104,826									
7. Increase (decrease) in estimated net incurred losses and expenses from end of policy year	36,559	21,702	9,867	6,349	11,550	10,256	1,386	(3,292)	(6,343)	

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5. Administrative Cost Allocation

State law (Section 39-71-2352, MCA) requires MSF to separately determine and account for administrative expenses and benefit payments for claims for injuries resulting from accidents occurring before July 1, 1990 (Old Fund) from those occurring on or after July 1, 1990 (MSF). The law also limits annual administrative costs of claims associated with the Old Fund to $1.25M. MSF allocated $955K and $1.25M in administration costs to the Old Fund in fiscal years 2010 and 2009, respectively.

6. MSF Distributions

During the fiscal year ended June 30, 2010, the MSF Board of Directors authorized a dividend to policyholders. MSF paid dividends to eligible policyholders in the amount of $2.0M for the policy year 2007. The MSF Board of Directors authorized and MSF paid a dividend of $4.0M in fiscal year 2009 for policy year 2006.

7. Old Fund Net Asset Position

Net assets consist of the net excess or deficit of assets over liabilities.

Section 39-71-2352 (5), MCA, provides for the payment of excess funds from the Old Fund to the State of Montana General Fund based on adequate funding levels in the Old Fund. This law defined the term "adequately funded" to mean the present value of:

a) the total cost of future benefits remaining to be paid; and,
b) the cost of administering the claims

Section 39-71-2352 (6), MCA, requires the transfer from the State of Montana General Fund any amount necessary to pay claims from the Old Fund.

There were no excess funds to transfer to the General Fund as of June 30, 2010 and June 30, 2009. In order to value liabilities consistently with investments, the estimated claims liability discount rate is 3.5% in fiscal years 2010 and 2009. The Old Fund net asset level, using a present value discount factor of 3.5%, is ($48.2M) as of June 30, 2010 and ($45.5M) as of June 30, 2009. Based on the current actuarially estimated payout patterns for the Old Fund, the cash and invested assets are expected to be inadequate to cover the total obligations through fiscal year 2011. State law requires the General Fund to satisfy all outstanding claims when the Old Fund has liquidated all financial resources and cannot meet its obligations.

8. Compensated Absences

MSF supports two leave programs, the State of Montana Leave Program, (Traditional Plan) and the MSF Personal Leave Program, implemented in January 2002. The State of Montana Leave Program covers union represented employees who have elected to remain in the plan. These employees accumulate both annual leave and sick leave and MSF pays employees 100% of unused annual leave and 25% of unused sick leave upon termination. MSF also pays 100% of unused compensatory leave credits upon termination to non-exempt employees in the Traditional Plan. MSF Personal Leave Program covers all non-union employees, union employees hired before July 26, 2006 who have elected to adopt the plan, and all employees hired after July 25, 2007. Employees in the Personal Leave Program accumulate personal leave and extended leave. MSF pays employees for 100% of unused personal leave upon termination but extended leave has no cash value at the time of termination.

The total compensated absences liability for MSF is $2.6M for fiscal year 2010 and $2.5M for fiscal year 2009. As a portion of the Old Fund administrative cost allocation, MSF allocated $2K of compensated absences costs to the Old Fund in fiscal year 2010 and $7K in fiscal year 2009.

9. Retirement Plans

MSF and its employees contribute to the Public Employees' Retirement System (PERS), which offers two types of retirement plans administered by the Public Employees' Retirement Board (PERB). The first plan is the Defined Benefit Retirement Plan (DBRP), a multiple-employer, cost-sharing plan that provides retirement, disability and death benefits to plan members and their beneficiaries. Benefits are based on eligibility, years of service and highest average compensation. Vesting occurs once membership service totals five years. Benefits are established by state law and can only be amended by the legislature.

The second plan is the Defined Contribution Retirement Plan (DCRP), created by the 1999 legislature and available to all active PERS members effective July 1, 2002. This plan is a multiple-employer, cost-sharing plan that also provides retirement, disability and death benefits to plan members and their beneficiaries. Benefits are based on the balance in the member's account, which includes the total contributions made, the length of time the funds have remained in the plan, the investment earnings less administrative costs.

Eligible PERS members choose to participate in either the DBRP or DCRP but may not be active members of both plans. MSF employees were required to contribute 6.9% of annual compensation in fiscal years 2010 and 2009. The employer (MSF) is required to contribute 7.17% of annual compensation in fiscal years 2010 and 2009. MSF's contributions amounted to $1.2M for fiscal year 2010 and $1.1M for fiscal year 2009. MSF and its employees paid one

hundred percent of required contributions to PERS and there is no unpaid liability as of June 30, 2010.

The PERS financial information is reported in the Public Employees' Retirement Board *Comprehensive Annual Financial Report* for the fiscal year-end. This information is available from PERB at 100 North Park Avenue, Suite 220, P. O. Box 200131, Helena, MT 59620-0131, (406) 444-3154.

MSF and its employees are eligible to participate in the State of Montana Deferred Compensation Plan (457 plan) administered by the PERB. The Deferred Compensation plan is a voluntary, tax-deferred retirement plan designed as a supplement to other retirement plans. Under the plan, eligible employees elect to defer a portion of their salary until future time periods. MSF incurs no costs for this plan.

10. Leases and Commitments

MSF leases office facilities under various operating leases that expire through December 2015. Rental expense for fiscal years 2010 and 2009 was $314K and $320K, respectively.

MSF leases 350 parking spaces in a parking garage that was built by the City of Helena adjacent to the MSF facility that expires June 30, 2040. The cost of the parking spaces will be the same monthly rate as equivalent parking passes sold by the city. The parking facility opened in conjunction with the move to the new building in June 2010. The annual subsequent parking cost is estimated to be $235K with potential to change based on parking rates assigned by Helena Parking Commission.

The future minimum rental payments are as follows:

Fiscal Year	Amount
2011	$ 286,091
2012	264,193
2013	262,419
2014	254,745
2015	238,448
Thereafter	5,881,624
	$ 7,187,519

11. Other Post-Employment Benefits (OPEB)

Beginning with the fiscal year ending June 30, 2008, the State of Montana implemented Governmental Accounting Standards Board (GASB) Statement 45, Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions. This statement requires the disclosure of employer liability for retiree medical subsidies and other post-employment benefits. The OPEB liability at June 30, 2010 and June 30, 2009 are $2.6M and $1.8M respectively.

Post-employment Healthcare Plan Description:

MSF employees and dependents are eligible to receive health care through the State Group Benefits Plan administered by the Montana Department of Administration. In accordance with section 2-18-704, MCA, the State provides optional post-employment medical, vision and dental health care benefits to the following employees and dependents who elect to continue coverage and pay administratively established premiums: (1) employees and dependents who retire under applicable retirement provisions and (2) surviving dependents of deceased employees. For GASB 45 reporting, the State Group Benefits Plan is considered an agent multiple-employer plan and MSF is considered to be a separate employer participating in the plan.

In addition to the employee benefits described in Note 9 Retirement Plans, the following post-employment benefits are provided. Montana Department of Administration established retiree medical premiums vary between $260 and $916 per month depending on the medical plan selected, family coverage, and Medicare eligibility. Administratively established dental premiums vary between $34.10 and $58.00; vision premiums vary between $7.64 and $22.26; both premiums vary depending on the coverage selected. Basic life insurance in the amount of $14,000 is provided until age 65 at a cost of $1.90 per month to the retiree. The State Benefit Plans reimburse all validated medical claims net of member obligations (annual deductibles and coinsurance of the members' selected medical plan). Dental claims are reimbursed at 50% to 100% of the allowable charges, depending on the services provided. The State acts as secondary payer for retired Medicare-eligible claimants.

Benefits Not Included in the Valuation:

Retirees pay 100 percent of dental premiums. Thus, there is no liability for dental valued in this valuation. The vision benefit is fully-insured and retirees pay 100 percent of the cost. Thus, there is no liability for vision valued in this valuation. The life insurance benefit is a fully-insured benefit that is payable until age 65 with the retiree required to pay the full premium. There is no liability valued in this valuation for the retirees, though the required premium is an active/retiree blended premium. This liability would be insignificant to the overall results of this valuation.

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Funding Policy:

The following estimates were prepared based on an actuarial evaluation prepared as of January 1, 2009 for the Department of Administration and the resulting State of Montana Actuarial Valuation of Other Post-Employment Benefits Plan (plan) contains the MSF data and is available through:

Montana Department of Administration
State Accounting Division
Room 255, Mitchell Bldg.
125 N Roberts St
PO Box 200102
Helena, MT 59620-0102

GASB 45 requires the plan's participants, including the MSF, to report each year the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year of retiree health care costs and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The 2009 ARC is calculated for all the State plan's participants and then individually allocated to individual participants. The MSF 2009 ARC is estimated at $809K and is based on the plan's current ARC rate of 6.45% percent of participants' annual covered payroll. The MSF 2009 ARC is equal to an annual amount required each year to fully fund the liability over thirty years.

The amount of the estimated OPEB actuarial accrued liability at transition was determined in accordance with the GASB Statement 45, and liability is estimated at $8M for MSF. The actuarial accrued liability is the present value of future retiree and active employees who will retire and be eligible for benefits and expenses.

Actuarial Methods and Assumptions:

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future.

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Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents information that shows the actuarial value of plan assets and liabilities. In the December 31, 2009, actuarial valuation, the projected unit credit funding method is used. The actuarial assumptions did not include an investment rate of return since no assets meet the definition of plan assets under GASB 43 or 45. Annual healthcare cost trend rates of 10 percent for medical and 9.5 percent for prescription claims are used. The unfunded actuarial accrued liability is amortized following a 30-year level percent of pay amortization on an open basis, using a 4.25 percent discount rate and a 2.50 percent payroll growth rate assumption.

The State finances claims on a pay-as-you-go basis and does not advance-fund the OPEB liability. While this liability is disclosed for financial statement purposes it does not represent a legal liability of the State of Montana or MSF. Therefore, the following cost information shows no cost contributions made by MSF and no value for plan assets.

Annual Other Post Employment Benefits (OPEB) Cost:

MSF's allocated annual OPEB cost (expense) for year ending June 30, 2010 was $770K. The interest on the net OPEB obligation for year ending June 30, 2010 was $36K. For fiscal year 2009, MSF's allocated annual OPEB cost (expense) was $858K. The cost that was allocated to the Old Fund for the years ended June 30, 2010 and June 30, 2009 was $38K and $51K, respectively.

The MSF annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2010 and prior are as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/2008	858,215	0.00%	858,215
6/30/2009	894,689	0.00%	1,752,904
6/30/2010	808,837	0.00%	2,561,741

Funded Status and Funding Progress:

As of June 30, 2010, the most recent actuarial valuation available was completed by the State of Montana for the calendar year ending December 31, 2009, the MSF allocation of the plan was as follows:

Actuarial Accrued Liability (AAL)	$6,985,326
Actuarial Value of Plan Assets	$0
Unfunded Actuarial Accrued Liability (UAAL)	$6,985,326
Funded Ratio (Actuarial Value of Plan Assets/AAL)	$0
Covered Payroll (Active Plan Members)	$16,911,506
UAAL as a Percentage of Covered Payroll	41.31%

12. Subsequent Events

In September 2010, MSF agreed to a $1.25M settlement with Working Rx, Inc. subsequent to the fiscal year 2010 balance sheet date of June 30, 2010. This case was previously disclosed as a contingency in the notes to the financial statements because sufficient information was not available to determine the potential liability and cost. The agreement to settle for $1.25M occurred prior to the release of the audited financial statements, therefore, an expense and liability of $958K and $292K has been included in the fiscal year 2010 financial statements of MSF and the Old Fund, respectively.

13. Contingencies

Coles, Individually and as Personal Representatives for the Estate of Steven Bearcrane v. Black Ranches, Inc., Crow Tribal Court No. CAV 07-044, is a tort case filed against a policy holder of Montana State Fund. The case involves a wrongful death claim by the estate of an employee of the policyholder. Montana State Fund is providing a defense under a complete reservation of rights to the policy holder under Part Two of the State Fund's insurance policy, also known as employers' liability coverage. The policy limits in this case are $1,000,000. The exclusive remedy provisions of MCA Section 39-71-411 should bar this type of tort claim against the policy holder. However, if the plaintiffs are successful in convincing the court that MCA Section 39-71-411 does not provide a defense, and that the employer-policyholder was at

fault in causing the death of its employee, the damages may be substantial. The case was dismissed at the Crow Tribal Court level, and has been appealed to the Crow Tribal Appellate Court. The actual potential cost impact to the State Fund is not known at this time. Liability for Montana State Fund, up to its policy limits ($1,000,000), is reasonably possible.

Montana State Fund also is involved in a great deal of litigation in the areas of workers' compensation and disputes with policyholders. These are of a generally routine nature and there are no known matters at this time that will have a large and widespread financial impact.

REQUIRED SUPPLEMENTARY INFORMATION

Other Post-Employment Benefits (Financial Statement Note 11)

As of June 30, 2010, the most recent actuarial valuation available was completed by the State of Montana for the calendar year ending December 31, 2009. The State of Montana finances claims on a pay-as-you-go basis and does not advance fund the OPEB liability. Therefore, the funded ratio remains at 0% at June 30, 2010.

SCHEDULE OF FUNDING PROGRESS

Date	Actuarial Value of Assets (A)	Actuarial Accrued Liability (AAL) (B)	Unfunded AAL (UAAL) (B-A)	Funded Ratio (A/B)	Covered Payroll (C)	UAAL as a Percentage of Covered Payroll ((B-A)/C)
12/31/2007	$0	$8,079,405	$8,079,405	0.00%	$16,805,676	48.08%
12/31/2009	$0	$6,985,326	$6,985,326	0.00%	$16,911,506	41.31%

MONTANA STATE FUND

FUND'S RESPONSE

MONTANA STATEFUND

P.O. Box 4759 • Helena, MT 59604-4759
Customer Service 1-800-332-6102
Fraud Hotline 1-888-682-7463 (888-MT-CRIME)

November 17, 2010

Ms. Tori Hunthausen
Legislative Audit Division
Room 160, State Capitol
Helena, MT 59620-1705

Dear Ms. Hunthausen:

As always, Montana State Fund (MSF) appreciates the efficient and professional approach of the Legislative Audit Division staff involved in this audit of our governmental financial statements. Once again, we are pleased with your issuance of an unqualified opinion without any audit recommendations on the financial statements we have presented.

The management and staff of MSF are very proud of our continued accomplishments in serving Montana businesses. Montana State Fund is committed to the health and economic prosperity of Montana through superior service, leadership, and caring individuals working in an environment of teamwork, creativity, and trust. We continually strive to improve all aspects of our operations to ensure Montana businesses and the community will continue to benefit from a strong Montana State Fund many years into the future. Thank you for your assistance and assurance.

Sincerely,

Laurence A. Hubbard
President/CEO